Report on the investment of the money in the Veterans Trust Fund

as required by Section 3 of SF2336 of the 84th General Assembly

The Treasurer of State invests funds in accordance the standards set forth in chapter 12B of the Iowa Code and within the guidelines of the Treasurer's investment policy, which is available at www.iowatreasurer.gov. Investment goals prescribed in 12B.10 are as follows:

a. **Safety** of principal is the first priority.
b. Maintaining the necessary **liquidity** to match expected liabilities is the second priority.
c. Obtaining a **reasonable return** is the third priority.

The money in the Veterans' Trust Fund (approximately $17M) is currently invested together with all other state funds in one pooled investment account (approximately $3B) managed by the State Treasurer. This approach, which is similar to that of a money market mutual fund, benefits the participating funds in various ways.

Liquidity: The high degree of liquidity offered by the pool eliminates the need for agencies to predict how long their funds can be invested.

Stability: Each dollar invested in the pool is managed to be worth one dollar tomorrow plus income at a competitive interest rate. Safety of principal is the Treasurer's first priority.

Diversification: The size of the pool allows for diversification among issuers, security types, and maturities which minimizes risk to the participants.

Efficiencies of Scale: Large block sized transactions provide a lower cost, higher-yielding structure than is available to smaller portfolios. Administrative costs for a comingled pool are also lower than they would be for separately-managed funds, resulting in a better return for participants.

The pool is comprised mainly (70-80%) of US government agency obligations, with the remainder of the portfolio made up of high-quality, short-term corporate instruments and Iowa certificates of deposit. The average weighted maturity of the portfolio is just over one year. Year-to-date in FY13, the pool has an annualized return of .28%. This return compares well against the .18% median return of state and local government pools (TRACS Financial, October 2012) and the returns of commercially-managed prime money market funds. Institutional shares of Vanguard's Prime Money Market Fund, for example, have returned .11% over the past year. Given the current market environment, the Treasurer believes that pool's return is reasonable given the priorities of providing safety and liquidity to pool participants.

The Veterans' Trust Fund is classified as a non-expendable trust fund, meaning that the principal in the fund is not to be spent. Income on the principal of the fund, however, is used to fund programs for veterans. Interest rates are at historic lows. Not surprisingly, the current market environment has put pressure on these programs and raised questions about how to improve returns on the investment of the fund.

Attempting to improve the return for the Fund would expose it to more risk. We could withdraw the fund's balance from the pool so it could be invested in longer-term securities. Therefore, the Fund would sacrifice liquidity. As a non-expendable trust fund, one might think that liquidity is not an issue, but legislative action that directs spending principal is possible. Selling securities to raise cash to implement the legislation could result in a realized loss. In addition, extending maturities now would mean locking in record-low rates. Today's rates will not be attractive as the market recovers and trading bonds in order to take advantage of rising interest rates may cause a realized loss to the portfolio. We feel it would not be in the Fund's best interest to withdraw from the pool.